A Growth Programme for Industrial Renewal in Europe*

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European Industry in the Global Competition

Europe risks falling behind

The financial crisis, the sovereign debt crisis, macroeconomic imbalances, and intra-European tensions are leaving their mark. Europe is in danger of falling behind in the global competition. International rivals in Southeast Asia and North America are revealing Europe's weaknesses. While countries around the world are making up ground, the European economy will shrink by 0.5% this year – the United States (up 1.8%) and China (up 8.2%) will grow.

This development is not just an economic risk for Europe. Economic weakness will also damage Europe's reputation and reduce its influence on the world stage. The image of the European integration project and its function as a role model for other regions of the world is in danger of being damaged. Centrifugal forces in Europe are getting stronger and are threatening to destroy the integration success that has been achieved so far. Europe's geopolitical influence in the international community is waning. And European values – which combine the market economy with democracy, freedom and solidarity – are losing their attractiveness for other global regions.

Economic strength is essential for consolidating government finances

The escalation of the eurozone crisis poses the greatest threat to Europe's prosperity today. Since the fall of the investment bank Lehman Brothers in 2008, the collapse of deregulated financial markets and their highly speculative products, and the subsequent sharp downturn in the real economy, more and more countries in the eurozone have been falling into the vicious circle of debt, refinancing crises, recessions, and ever-higher debt quotas. There is an urgent need to consolidate public budgets. Yet restrictive fiscal policy alone will not suffice. The anti-crisis strategy of issuing emergency loans and making budget cuts has increased risks for creditors rather than reduced them. The first bailout package for Greece in spring 2010 cost €110 billion. Two years later, aid programmes for Greece, Ireland, and Portugal now total €403 billion. Two years ago Germany had to guarantee €22.5 billion in emergency loans. Today it is backing a sum of €211 billion. The introduction of a permanent European Stability Mechanism (ESM) means that this amount will continue to grow. In addition, the ECB has amassed serious risks amounting to more than €1 trillion

as a result of buying government bonds in the secondary market and handing out low-interest loans to hard-hit banks.

Unless there is a breakthrough in the current recessionary spiral, no one will be able to guarantee repayment of these loans. Europe, and especially creditor nations like Germany, are banking on a trend shift that they hope will provide new economic verve. The EU and IMF rescue packages assume that the countries receiving emergency loans today will soon be able to generate primary budget surpluses. If that fails to happen, they will keep needing new loans to prop them up. This will put the eurozone countries to a test of fiscal strength and, above all, political endurance. Ultimately, it could lead to the collapse of the monetary union.

Setting a course that focuses on the real economy

The debt sustainability called for by the adjustment programmes will only be achieved when Europe regains its capacity for economic growth. That will not happen by itself. Europe will need a growth programme if the consolidation of government finances is to succeed. However, this must not lead to a new round of government debt for the sake of short-lived economic stimulus measures. Instead, Europe needs a comprehensive investment and development programme that overcomes the financial crisis, sets a course that focuses on the real economy, modernises structures, improves competitiveness, increases value added, and strengthens European unity.

The financial crisis exposed the source of European imbalances. If we do not work to fix them, they will lead to a deeper, more serious split. Europe has lost its equilibrium. While countries like Germany and Poland manoeuvred through the crises relatively safely, the economies of countries in the southern eurozone are nose-diving. There is no end in sight to their downward spiral. No wonder growth forecasts diverge so widely between countries in Europe. Poland and Lithuania are expected to grow by 2.5% and 2.3% respectively, while Greece and Portugal are set to shrink by 3% and 3.2% respectively.

Weak growth almost always goes hand in hand with a weak status of real value added. The manufacturing sector has lost its significance in nearly every European country. During the last decade, industry’s share of GDP fell on average from 23% to 16%. However, it is clear that countries which held on to their industrial sector are now doing significantly better than countries that pursued de-industrialisation. Poland is an impressive example. It is the only EU country to have increased its percentage of industrial value added over the last 10 years. That has been good for Poland – it is also the only EU country to come through the crisis without going into recession, and it continues to grow more strongly than almost every other country on the continent. Germany experienced a relatively small decline in its industrial value added during the crisis. And Italy’s comparatively high degree of industrialisation remains a secure anchor as the country heads towards its upcoming structural reforms. Preserving a broad value chain secures jobs and creates an environment that spurs on new growth.

In addition to retaining a solid industrial basis, boldly implementing structural reforms has also paid off. Germany, for example, has spent the last decade reforming its labour market, which has strengthened its competitiveness for the long term. And following a painful slump during the crisis of 2008-2009, Lithuania introduced structural reforms that have enabled it to set out on a new path to growth.

A multi-faceted economic area facing shared responsibilities

Europe is an economic area that is characterised by diversity and heterogeneity. The European Commission therefore puts Member States into one of four groups, based on their industrial focuses:

- Countries with technology-based, knowledge-based, training-intensive, highly innovative sectors, some of which are strongly export-oriented
- Countries with a labour-intensive industry that is based less on technology and knowledge, and where the domestic market plays a larger role
- Countries in Eastern Europe that have successfully implemented structural change and are in the process of catching up and developing an industrial sector with highly innovative, technology-dominated subsectors
- Eastern European countries that have made less progress in catching up and are characterised by labour-intensive, less technology-oriented businesses with strong growth

The diversity in European economies shows that it is impossible to lump Europe together. Every country has different strengths and weaknesses. Yet they all have one challenge in common: dealing with structural change. Demographic change, a more international division of labour, dwindling resources and the shift towards a knowledge economy are all major trends that require adjustments in every European country. The challenges are huge. But the odds of overcoming them together are much higher than the current mood would have us believe.

Industrial Recovery – A Model for Industrial Renewal

Guided by shared strength

Despite all their differences, EU Member States share one guiding principle: the European model of integration and progress based on all EU countries and their citizens participating in economic progress. In other words, one country's strength is another country's strength as well. Countries with a strong export base depend on the economic health of their European buyer countries. Similarly, a country like Germany with strong exports *and* imports can only do well in the long run if its buyer *and* supplier markets in Europe are in good economic shape. And Eastern European countries that are still catching up need highly innovative companies from more developed EU countries to invest in Eastern Europe and introduce new technologies.

Mutual dependence and economic interconnectedness in Europe is on the rise. National borders are losing their significance. Value chains in the EU have long extended beyond the borders of national economies. The German automotive industry is an outstanding example, as its competitiveness would be unthinkable without its network of suppliers in Central and Eastern Europe. Germany procures semi-finished industrial products from numerous European countries. It is the biggest importer in the EU.

Therefore Germany cannot do well in the long run if Europe is struggling. Our guiding principle for combating the crisis and bringing economic recovery to Europe should be "together we are stronger".

Europe: a global pioneer of sustainable economics

The turbulence of the banking and financial crises have clearly shown that in an interconnected Europe the industrial sector is a safe bet for real value added. It accounts for 35% of Europe's workforce. On average, each job in the industrial sector is also linked to two high-quality jobs in the service sector. In the automotive industry alone, each job creates five other jobs.

The industrial sector is home to the hallmarks that set Europe apart from the rest of the world – innovation, quality and expertise, and solutions and products for an era facing the switch to renewable energy, dwindling natural resources, climate change, aging populations, and increasing mobility and communication. An innovative industrial sector is almost the only branch of the economy to be so closely associated with the basic pillars of a sustainable, globally competitive economy. Productivity growth is more than twice as strong in the industrial sector as it is in the average EU sector. And industrial R&D spending makes up more than half of all research spending in the EU.

Shared European challenges and mutual dependence also mean that industrial renewal will only succeed if everyone involved – businesses, governments and citizens – works hand in hand as a community. European businesses are at the forefront of this renewal. They invest in innovative technologies and create good jobs. National governments fulfil their responsibility of providing incentives for advancing infrastructure and education systems. The EU provides cross-border synergies and public banks that are able to act. Social partners create a positive climate for investment and good working conditions. And citizens recognise industrial renewal as a way of participating in technological progress and as an essential building block for social peace.

The European Commission's industrial policy initiatives are a first step towards European industrial renewal. The initiatives define several action areas for securing a competitive European industrial sector. Europe now needs to initiate real measures that actively promote growth and are flanked by an appropriate fiscal policy.

A Change of Tracks towards a new Investment Strategy

Strategy for an investment and development fund

Intelligent budget consolidation involves more than just making savings in areas where there is wastefulness and harmful bureaucracy. It also requires investments that create new stimulus for growth. This is the only way to prevent a downward spiral into recession. It is the reason why any austerity programme needs to be accompanied by a growth programme. European industrial renewal coupled with a growth programme offers an alternative to one-sided policies fixated on spending cuts, losses to prosperity and out-of-control debt.

In our view, a growth programme must rest on two pillars: structural reforms *and* growth-oriented fiscal policy. Creating competitive structures with functioning labour markets and administrations subject to the rule of law is essential, but it is not enough. Without fiscal policy as a driving force, industrial renewal will fail. We need to pool the investment potential of public authorities and the private sector, and focus these on innovative growth areas.

Imposing taxes on financial markets instead of getting into more debt

A growth programme needs an investment and development fund for Europe's industrial renewal – but this fund must not undermine consolidation efforts at the national level. In contrast to conventional economic stimulus programmes, it should not be financed with new debt but should rather pool existing resources from the EU's Structural Funds and be nourished with revenue from a financial transaction tax. The funding to be disbursed from the Structural Funds between now and the end of 2013 amounts to €232 billion for the EU as a whole. Of that, more than €13 billion is allotted to Greece, and more than €4 billion of that has not yet been earmarked for specific projects and is therefore still available. A Europe-wide financial transaction tax as proposed by the European Commission could generate €55 billion each year. Policymakers are now much more willing to tax

the financial markets. But it would be impossible to impose such a tax across all 27 Member States at this time. This is why we are aiming for a coordinated approach by those countries that are ready to take this step. They include the two biggest EU economies, Germany and France, as well as Italy, Spain, Portugal, Austria, Belgium, Finland and Greece. So at least nine EU countries have the opportunity take an initiative by increasing their collaboration. A great deal now depends on the political will of the governments to get serious about a financial transaction tax.

Looking ahead to 2014 and beyond, the goal should be to combine resources from the financial transaction tax with resources from the European Structural Funds under the new multiannual financial framework. Incidentally, the fruits of an intelligent use of EU investment funding can be seen in Poland, a country that is driving European growth. Poland has received more money from the Structural Funds than any other EU country.

Strengthening the European Investment Bank

The European Investment Bank needs to take on a key role. We want to upgrade its status in the European institutional hierarchy and have it assist the upcoming European Stability Mechanism (ESM). There must be a significant increase in the bank's equity and investment capacities.

Driving force for private investment

Our programme is intended to pilot and drive new possibilities for private capital. In addition, introducing this investment and development fund will significantly increase potential investment volume by mobilising private capital. "Project bonds", for example, can be used to trigger far more private investment, and lowering co-financing requirements can enable faster use of funding.

A Concept for Industrial Renewal

A growth programme *for* Europe needs to be jointly developed in Europe. This is the only way to create win-win situations for all European partners. Every European partner should be capable of contributing to this bottom-up process. This is the only way to ensure that the renewal of European industry is in the hands of those who know the sector best. The industrial sectors of EU Member States are heterogeneous; their labour, production and innovation systems are different. There is no one and only approach for successful industrial policy. Europe's value-added structures should not be standardised, nor should they be centrally managed.

Instead, the focus should be on tackling shared challenges in policy reforms as well as on identifying horizontal and sectoral action areas for European industrial policy.

Structures under the rule of law, good governance

A modern public administration is an essential prerequisite for economic recovery, and even more so for strengthening innovative industrial sectors. New economic growth will only thrive if people can trust the public administration to work efficiently and under the rule of law. Investment requires an investment-friendly environment and a high degree of transparency and planning certainty. Obstacles to investment resulting from bureaucracy and inefficient administration need to be cleared away. This involves ensuring that there is a working system of tax collection via national authorities, quick approval processes and one-stop solutions for urgent infrastructure projects. The informal sector also needs to be broken up, particularly in the areas of illicit work and illegal imports.

Improving conditions for industrial renewal

We define horizontal action areas as cross-national and cross-industry instruments that create favourable conditions for industrial renewal. Strengthening and modernising them means doing something good for every type of value chain. The following areas serve as examples:

Research and innovation: To compete with global competitors, Europe needs to invest more in cutting-edge products and sustainable processes. Financial resources need to be made available for companies that are willing and able to engage in research, and incentives need to be improved. This applies to the European and the national level. EU funding for research and innovation should be raised to 10% of the EU budget. And Member States should strive to invest 3% of GDP in research. Setting benchmarks, standards, and product-specific regulations can also help drive innovation funding and long-term competitiveness.

Training and labour markets: Today's excessively high rate of youth unemployment is unacceptable. Employees often have qualifications that do not meet the requirements of European industry. Everyone must be able to access the labour market at the end of their training. Action needs to be taken immediately to integrate younger people into the labour market; topping up the European Social Fund (ESF) to finance catch-up training and wage subsidies can be one tool for achieving that goal. We must also promote labour mobility within Europe. International teams will be the norm in the future. Multinational companies with several European offices are already working like this; we should now create mobility programmes to make the job easier.

Regional clusters: Europe and its industries are complex. Differentiation and specialisation define sector development. Developing regional structures is crucial for strengthening European industry. Competition clusters and innovation networks involving companies, universities, research centres, technology service providers, educational institutions and business networks all help to strengthen value chains. Knowledge-intensive industrial sectors and services are concentrated in metropolitan areas. Innovative clusters and networks should be developed in a more targeted way to ensure that knowledge transfer, research, infrastructure, and further training are promoted in a coordinated manner.

Financing terms for businesses: The real economy is already in danger of a credit crunch in some European countries. Highly competitive companies are being held hostage by national refinancing problems and can only get capital on anti-competitive terms. Businesses and regions that invest in innovation and real value added therefore need more and better access to financial instruments. SMEs are very important in the European industrial landscape, especially for ensuring a lasting supply of jobs at the regional and local level. Possible instruments include: boosting the EIB's facility for financing high-risk, innovative projects, particularly those that involve business start-ups; and increasing the capacities of loan guarantee systems and micro-loan programmes.

Developing lead markets

In addition to these horizontal action areas, we also need to identify Europe's lead markets in the various sectors. Where European industry is strong, we need to maintain its advantage over international competitors. Where European industry is languishing and its potential lies dormant, we need to renew it and make it competitive.

Mobility: The **automotive industry** has a high status in Europe. It is characterised by broad value chains that often extend across sectors and countries. In order to hold on to this value-added potential and ensure that Europe can assert itself as a location for sustainable and innovative

automobile production, we must investigate structural change and the ways each country can help to optimise value added. **European rail technology** and the **aviation industry** are among the best in the world. **Logistics** in general is also one of Europe's high-performing, labour-intensive and globally networked sectors.

Infrastructure: Innovation cycles are speeding up in the energy, transport and telecommunications sectors. These sectors also cut across many areas of entire national economies. If we want to be global pioneers in these fields, we must quickly adopt state-of-the-art technologies, particularly where this aids the development of the single market. One instrument of use in this regard involves increased funding for developing cross-border infrastructure. Using project bonds to mobilise additional private investment capital can significantly speed up the expansion of modern infrastructures.

Energy and resource efficiency: Energy and resource efficiency is becoming an increasingly important competitive factor. Higher resource productivity and efficiency, and more reuse and recycling have already bolstered the global competitiveness of European industry. But there is still plenty of room for improvement. At the same time, Europe's industrial sector needs a long-term energy policy that guarantees reasonable prices and supply security and that fully exploits the enormous potential that the sector has for improving energy efficiency.

Healthcare: The demographic change is affecting all European countries. As a result, the healthcare sector is becoming increasingly important. Healthcare offers great opportunities for growth and employment. This applies to industrial pharmaceuticals and to service-oriented healthcare, whose numerous products, services and facilities make it one of the largest submarkets in the European economy. In Germany alone the healthcare sector employs around 4.2 million people and generates revenues of approximately €240 billion, which equates to 11% of its GDP.

Other lead markets are conceivable within a heterogeneous Europe. Alongside the core industrial sectors, **tourism**, for example, is hugely important for the economy – particularly in southern European countries like Spain, Portugal and Greece. In those countries, tourism accounts for between 12% and 15% of GDP. Indeed, tourism throughout Europe is an important branch of the economy. In 2006 around 340,000 companies employing 2.8 million people were active in the fields of accommodation and travel organisation. More and more holidaymakers favour high-quality and sustainable tourism. Europe could become a global pioneer in combining human recreation with nature conservation.

The **food industry** is also very important in southern European countries. In Greece, Portugal and Spain it is the biggest branch of industry, while in Italy it is the third biggest. To date, however, value-added and export potentials have not been adequately exploited. Sales generally focus on domestic markets, and production synergies are not sufficiently utilised because the sector is made up of many small companies. As yet, the potential of food processing, the refinement of agricultural products and the targeted development of high-quality, healthy food products remains unexploited.

Jointly developing a Programme for Industrial Renewal

Europe is at a crossroads. On the one hand, our mutual dependencies and obligations have grown considerably. On the other hand, old prejudices are being revived and are fomenting mistrust and discontent. But a Europe mired in despair can neither overcome the challenges we face today, nor can it bring self-confidence to its role on the global stage. There is a danger that economic imbalances in Europe will lead us closer and closer to a political breakdown. Our generation is

faced with the great responsibility, but also the great opportunity, of using this unique opportunity in our history to recognise our shared interests and to act accordingly.

It is time to begin writing the next chapter of our European history. Some things we have to tackle straightaway; with others, it will be years before we are finished laying the bricks. What matters most is that we have a clear will to succeed and a blueprint for achieving our goals. Like in previous decades, when we set out on groundbreaking paths towards establishing the single market, introducing a common currency, and expanding the EU to the east, we now need to initiate a step-by-step process that brings the community closer together.

We want to forge a European alliance by means of a joint concept for industrial renewal. This alliance would be committed to upgrading the real economy, installing transparent and efficient governance structures and bringing new economic vigour to Europe in an era defined by Europe-wide budget consolidation.

We want to inspire debate on this issue and are inviting our European partners to join us on the road towards economic renewal in Europe and the beginning of a new industrial age of sustainable prosperity.

We stand by Europe and believe in the future of the European idea. If we can master the current crisis in a spirit of solidarity and develop what we share in the interests of all European partners, we will emerge much stronger and more united.

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